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SUBJECT: Part III: PM VOWS TO DEFEND THE CURRENCY, REJECTS CAPITAL
CONTROLS AND TALKS RESERVES AND BALANCE OF PAYMENTS

REF: Hanoi 634 (Economic Data Sends HCMC Into a Panic)

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¶1. (SBU) Summary: The Prime Minister told a group of bankers on June 8 that the GVN has no plans to devalue the dong and will continue to intervene to defend the currency. He rejected the notion of capital controls, which he said would be a mistake. The PM further stated that Vietnam is not contemplating an IMF program. Shortly after his statements, the government of Vietnam (GVN) began cracking down on black market currency exchanges, which may affect Vietnam's small and medium enterprises. End Summary.

PM: NO PLANS TO DEVALUE THE DONG

¶2. (SBU) Prime Minister Nguyen Tan Dung met in Hanoi with representatives from JP Morgan and the Bank for Investment and Development of Vietnam (BIDV, one of the large state-owned commercial banks, not equitized) on June 8. (JP Morgan was given access to the PM via BIDV, with whom they have a business relationship.) The banks were required to submit their questions in writing before the meeting, which is not uncommon in Vietnam.

¶3. (SBU) PM Dung told the visitors that the GVN has no plans to devalue the dong. He noted that, even at this time of stress in markets, the overall balance of payments showed a small \$1 billion surplus in the first five months of 2008. He admitted that the GVN needed to send stronger and clearer messages about its resolve to maintain currency stability in order to reassure investors.

BLACK MARKET RATES BASED "ON RUMORS AND SPECULATION"

¶4. (SBU) The PM said that he believed that the higher black market exchange rate for dollars was not based on "true" supply and demand, but on rumors, speculation and the activities of some "commercial banks" (although he did not elaborate on the last point). He also acknowledged that offshore markets are pricing in a devaluation of the dong of up to 20-40 percent, but he does not believe this is an accurate reflection of where the currency is headed. He said that although up until now the State Bank of Vietnam (SBV) had not intervened substantially, intervention will increase in size and breadth in terms of counterparties. (Note: On June 9, the SBV made a public announcement that it would begin cracking down on black market currency exchanges. The exchanges that post usually contact to check black market dollar rates are now not answering their phones, and visible activity outside these shops has diminished considerably. There are even reports that plain-clothes policemen

have been posted outside these establishments.)

15. (SBU) The PM assured the bankers that potential foreigner portfolio outflows are manageable, relative to the size of SBV's foreign currency reserves. PM Dung added that he planned to ask the SBV whether it could report publicly the dollar level of FX reserves. (Note: A mid-level SBV official was quoted in the press on June 9 reporting that its foreign currency reserves were at \$22 billion. This squares with what our contacts at the SBV told us early last week - "about \$20 billion.") The PM said that he is aware that Vietnam has the ability to tap the swap lines set up through the Chiang Mai Initiative. Drawing on the swap lines has been studied and they are keeping it in view.

CAPITAL CONTROLS "A MISTAKE"

16. (SBU) PM Dung also told the bank representatives that he is confident that the balance of payments will return to a significant surplus in the medium term. With this medium-term view in mind, he said that the SBV can intervene more aggressively now, if that is what it takes to restore market confidence in the GVN's ability to maintain a stable currency. The imposition of capital controls is not/not being considered, he said, and added that he thought such controls were a mistake and went against Vietnam's commitment to freer markets.

MAINTAINING CONFIDENCE

17. (SBU) The PM added there were two key points for maintaining local confidence in the economy. First, depositors must be assured of the overall stability of the banking sector and second, dong deposit rates must be attractive. The PM said he would act to make sure both occur. He also said that Vietnam will not enter into a

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program with the IMF.

18. (SBU) Comment: The PM's comments and the subsequent release of the reserve level show that the GVN is getting the message on transparent and public action. While many of the PM's statements are reassuring, the move to crack down on black market currency exchanges may carry negative ramifications for Vietnam's small and medium sized businesses (SMEs). These businesses are already having a difficult time obtaining the capital they need to conduct legitimate operations, while the big SOEs gobble up available dollars through preferred lending with certain banks (Reftel). This state-bias is also important because most observers believe that profligate state-sector spending is a major contributing factor to Vietnam's current inflation woes. While the SBV announced on June 9 that it was directing state banks to make some credit available to Vietnam's aquaculture industry, which had been virtually excluded from the credit markets due to credit tightening measures, many thousands of other private sector firms continue to be frozen out of official mechanisms for borrowing money and obtaining foreign currency to purchase inputs. Closing down the black market may completely eliminate the only source of foreign currency for these SMEs, or drive the black market rate much higher (or a combination of both.) End comment.

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